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Airport-airline relationships and contracts: a proposal

The last two decades have witnessed remarkable changes in European aviation, the consequence of a series of inter-related, largely symbiotic developments. These include: airline de-regulation; the use of information technology and the internet; new managerial approaches (product unbundling and differentiation) and the commercialisation of the airport industry. The developments were symbiotic not least because de-regulation encouraged competition and entrepreneurial activity, which in turn stimulated new technology and managerial innovation; substantial increases in productivity leading to a marked fall in the real cost of air travel across a hugely expanded network of services, has been the outcome.

Changes to the aviation industry supply chain and specifically changes to the relationship between airlines and airports are a less known, little appreciated facet of the foregoing. In the past, the airport's schedule of charges and associated conditions of use were central to the airport-airline relationship. They formed part of an implicit contract which an airline was deemed to have accepted once it started to use an airport. Less evident were the airport's broader responsibilities with respect to what, in practice, proved to be a fairly uniform quality of service. Conversely, there was no formal commitment by an airline to an airport. However, these two aspects, service quality and commitment by the downstream customer, have assumed greater importance as airlines have become more heterogeneous in their product offerings and business models and, in the case of EU registered airlines, exercised their newly established freedom of establishment through-out the EU. Airlines for their part desire tailor-made facilities and service provision whilst airports wish for reduced passenger-volume risk in order to under-pin investments made in such facilities and services. The result has been to increase the use of bi-laterally negotiated supply contracts between individual airlines and airports thus superseding standard charging schedules and uniform conditions of use[2].

An inevitable outcome of the bilateral negotiations has been a range of contracts with heterogeneous characteristics but there are, never the less, a number of defining features. The contracts place obligations on both parties. Those placed upon the airport focus upon the standards that the airline can expect with respect to aircraft turnaround times, baggage handling and the treatment of the passenger. In the longer term, with volume growth, such obligations can be met only by investment and sometimes the airport's investment intentions are included in longer term contracts. The airline for its part agrees to base a specified number of aircraft at the airport and sets out a programme for increasing their number, sometimes going so far as guaranteeing passenger numbers. All these obligations are then wrapped around an indexed price (charge) which usually compresses the many separate charging components of the traditional posted tariff into a simple singular charge expressed

[1] Visiting Research Fellow. I would like to thank David Gillen for helpful comments.

[2] In the UK for example, most major airports now have such contracts with their airlines. London Gatwick, the UK's second largest, has recently indicated its intention to adopt this approach. London Heathrow, as might be expected, remains the major exception to the trend.

as $/£/E per departing passenger[3]. This has the effect of sharing volume risk; the airline is no longer paying a fixed charge for landing a half-empty plane. Finally, there is the important issue of the contract term. The airport prefers a term of long duration to provide stability for planning purposes in what is now a rapidly changing market place; the airline prefers a short duration to provide for flexibility for when market conditions change. In the event, some contracts have been written for periods of 10 and even 20 years.

Such long term contracts are symbolic of more optimistic times that preceded the financial crisis; recent contracts tend to be of shorter duration. What is surprising is that in spite of the recession and its adverse impact on air travel, particularly in the UK where currency movements have compounded the situation, contracts appear to have stuck. Indeed, the one example of an airline seeking to walk away from a contract pre-cedes the recent economic recession. The (appeal) court found in favour of the airport and this together with the recent economic recession has encouraged airlines to seek short contracts. But, for the airport, not enjoying the airlines' advantage of being able to 'wing' capital between European airports and facing potentially capricious behaviour by those airlines not bound by contract terms, the prospect is unappealing. The risk is that the market will begin to ossify to the ultimate detriment of the consumer.

What is the way forward? I would suggest that it is to extend the market; to develop a market in contracts whereby the unexpired term of a contract can be bought and sold between airlines. The analogy here is the sale of a lease held on the assets of a residential or commercial property. And like the property market, one might expect intermediaries to facilitate the transactions as indeed, they have done in relation to the trading of slots at congested airports. By accepting the contracts as an asset that can be traded between parties the potential effect would be to establish a market with liquidity and that, in turn, would encourage the writing of longer-term contracts which will benefit the airport. Therefore, the airports too have an incentive to agree to the trading of contracts. Finally, by encouraging the writing of contracts of longer duration, the trading process would facilitate investment in airport infrastructure and thus be advantageous for the passenger and the economy at large.

[3] With contingencies for force majeure associated, for example, with changes in security requirements.